IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1945

No. 436

M. M. ARGO,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I

The Opinions of the Courts Below

The opinion in the Tax Court of the United States is reported in 3 T. C. 1120, was issued on September 30, 1944, and is shown on pages 83-90 of the record in this case. The opinion in the United States Circuit Court of Appeals for the Fifth Circuit is reported in 150 Fed. (2d) 67 (Adv.), was issued on June 20, 1945, and is shown on pages 162-165 of the record in this case.

II

Jurisdiction

(1) The jurisdiction of this Court is based on Section 240(a) of the Judicial Code, 28 U. S. C. A., Sec. 347, as amended by the Act of February 13, 1925.

(2) The date of the judgment to be reviewed is June 20, 1945 (R. p. 165).

III

Statement of the Case

In the interest of brevity, we are not stating again here the facts set forth in the Petition, under the heading, Summary Statement of the Matter Involved. Reference to that Statement is made.

We deem it inappropriate to include in this brief a detailed statement regarding the proceedings and the evidence before the Tax Court. We shall, however, briefly summarize the evidence relating to the question whether Birmingham Electric & Manufacturing Company, which was adjudicated by the former judgment to have existed as a partnership for income tax purposes throughout the year 1937, continued to be operated in the same manner during the years 1938, 1939, and 1940, the tax years here involved; and we shall briefly point out the evidence which is contrary to two of the statements of fact set forth in the opinion of the Tax Court.

Summary of Evidence as to Change in Company's Operations

The assets of the company were of the same character and of approximately the same value at the end of 1937 and at the end of each of the tax years here involved, i. e., 1938, 1939, and 1940 (R. pp. 118, 128, 137, 157). Cash

expenditures of the same character (the principal items each year being merchandise bought for sale, labor on materials for sale, other salaries and wages, auto and truck expense, and shop expense) were incurred each year in the following amounts: 1937, $120,882.89; 1938, $111,739.72; 1939, $119,439.22; 1940, $140,367.10 (R. pp. 111, 122, 132, 153). The "cost of goods sold" was as follows: 1937, $82,557.51; 1938, $80,066.98; 1939, $89,447.38; 1940, $102,-079.22 (Ibid.). The average number of employees each year was: 1937, 30; 1938, 26; 1939, 25; 1940, 27 (Respondent's Exhibits H-M, certified in original form).

Sarah Ellen Argo, one of the partners, and petitioner's youngest child, did no work for the partnership, either in 1937 or in the tax years here involved (R. p. 54). Esther B. Argo, petitioner's wife, did work of a clerical nature, without salary, "on many occasions," mostly on week ends and at night, during the years 1937, 1938, 1939, and 1940. "She worked more during the later years" (R. pp. 53, 60, 62). In 1937 and 1938, Malcolm M. Argo, Jr., a college student of engineering, and petitioner's oldest child, did part time work for the company without salary assisting with the management and working on electric equipment (R. p. 53, 56). Throughout 1939, and the first part of 1940, he attended college in another town. After he graduated as an electrical engineer in June 1940, he worked for the partnership "full time and overtime" until he entered the U. S. Army, Corps of Engineers, in October, 1940 (R. p. 57). In 1937 and 1939 and 1940, Ann Argo (later Ann Argo Dudley) worked on holidays and during vacations, without salary, doing filing and stenographic work. From October 1, 1940 (she having graduated from college in September 1940) until the end of the year, she worked full time, without salary, in the carbon brush department, doing general work in making brushes (R. pp. 53, 58, 59). During 1937 and the three tax years here involved, Mrs. Argo, Mal-

colm M. Argo, Jr., and Ann Argo had authority to draw and drew money from the bookkeeper of the partnership "whenever they needed it" (R. p. 53).

The petitioner, a graduate electrical engineer, acted as general manager throughout the years 1937, 1938, 1939, and 1940. He earned substantial amounts for work for persons other than the partnership, receiving $4,600.00 sales commission and $1,800.00 for professional services in 1939, and $2,000.00 for such services in 1940 (R. pp. 54, 78; petitioner's Exhibits 8 and 14, certified in original form). Under the partnership agreement, petitioner received $6,000.00 of the partnership annual profits and the remaining profits were divided equally between the other partners. The income distributed annually to each of the other four partners was as follows: 1937, $2,496.72; 1938, $1,988.48; 1939, $1,164.21;[2] 1940, $836.47 (R. pp. 121, 131, 140, 153).

As to the operations of the partnership during the years 1937 through 1940, Malcolm M. Argo, Jr., testified:

> "Throughout the years we had the same arrangement that my father made with us. There has been no change in the partnership from the first day of 1937 to the present." (R. p. 57)

Virginia Bayne, bookkeeper for the partnership, testified:

> "Since 1937 no change has occurred in the partnership accounts. It continued to operate on the same basis as in 1937." (R. p. 62)

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[2] This figure is taken from the original return, showing $10,656.83 net income of the partnership, $6,000.00 distributed to petitioner, and $1,164.21 to each of the other four partners. As $4,600.00 of the total net income was subsequently conceded by petitioner to be his individual income from sales commissions (R. p. 78), the net income of the company was actually $6,056.83, leaving only $14.21 for each partner, after deducting the $6,000.00 due petitioner under the partnership agreement.

Evidence Contrary to Statements of Fact by the Tax Court

In its opinion, the Tax Court stated that it was not informed as to whether persons other than the partners were employed by the company. (R. p. 89) The record showed that the average number of persons employed, other than the partners, was as follows:

Year	*Employees*
1937	30
1938	26
1939	25
1940	27

(Respondent's Exhibits H-M, certified in original form.)

The Tax Court based its finding that petitioner had failed to show that his activities were not the main factors in producing the income of the company in part on its subsidiary finding that the annual earnings of the company were "50 per cent and more in excess of the capital investment in physical assets." This finding, in turn, was based on the figures shown by balance sheets of the company at the end of each year and fails to take into consideration money invested throughout the year.

The table set out below shows the total investment (including both physical assets at the beginning of the year and expenditures during the year), the larger items of expenditure, income, and percentages of return on the company's investment.

	1938	1939	1940
1. Physical Assets (land, buildings, machinery, inventory) at beginning of year	$24,874.40	$22,610.76	$18,817.45
2. Total expenditures	111,739.72	119,439.22	140,367.10
(a) Merchandise bought for sale	53,223.42	61,261.56	68,906.54
(b) Labor on materials for sale	26,353.62	26,576.89	34,118.15
(c) Other salaries and wages (excluding compensation to petitioner,)	11,512.00	10,377.75	10,863.00
(d) Auto and truck expense	3,159.71	2,593.24	2,644.88
(e) Shop expense	2,880.68	4,734.54	8,643.29
3. Total investment	136,614.12	142,049.98	159,184.55

	1938	1939	1940
4. Net income	13,953.91	6,056.83*	9,345.88
5. Percentage of return on above expenditures (Item 2)	12.49%	8.92%	6.66%
6. Percentage of return on Total Investment (including capital assets and expenditures during current year)	10%	4.2%	5.8%
7. 1/5 of Total Investment	27,322.82	28,410.00	31,836.91
8. Percentage of return to each partner other than petitioner	7.2%	.05%	2.6%

(R. pp. 111–115, 122–126, 132–135)

* $10,656.83, the figure shown as net income on the partnership return for 1939, is here corrected to $6,056.83, the remainder after deduction of $4,600.00, representing commissions conceded by petitioner to be taxable to him individually. (R. p. 78.)

IV

Specification of Errors

(1) The United States Circuit Court of Appeals for the Fifth Circuit erred in affirming the judgments of the Tax Court.

(2) The Circuit Court of Appeals erred in holding and deciding that the entire net income of the partnership, Birmingham Electric & Manufacturing Company, during the years 1938, 1939, and 1940 was taxable to the petitioner.

(3) The Circuit Court of Appeals erred in holding and deciding that the judgment of the United States District Court involving petitioner's tax liability for the year 1937 was not *res adjudicata* and did not operate as an estoppel by judgment as to the issues and questions here involved with respect to the year 1940.

(4) The Circuit Court of Appeals erred in failing to hold and decide that the Tax Court, in its consideration of the case involving the years 1938 and 1939, should have given weight to the former judgment of the District Court.

(5) The Circuit Court of Appeals erred in failing to hold contrary to law the decision of the Tax Court that

during the years 1938, 1939, and 1940, Birmingham Electric & Manufacturing Company was not a bona fide partnership for purposes of the federal income tax.

(6) The Circuit Court of Appeals erred in failing to decide and hold that the respondent has the burden of proving discontinuance of the partnership existence of which for income tax purposes has been once determined by the former judgment of the District Court.

(7) The Circuit Court of Appeals erred in failing to hold and decide that the partnership determined by the former judgment to have been in existence for income tax purposes during 1937 is presumed in the absence of proof to the contrary to continue to exist and to conduct its operations in the same manner.

(8) The Circuit Court of Appeals erred in failing to hold and decide that the following issues which were determined by the former judgment and which are material to a determination of the questions raised in the suit involving petitioner's income tax liability for the year 1940 were concluded by the former judgment:

> (a) The taxpayer on January 1, 1937, made valid bona fide gifts to members of his family of their several interests in the business.
>
> (b) The taxpayer on January 1, 1937, ceased to be the individual owner of the business and the several partners became the owners thereof.
>
> (c) A partnership valid for income tax purposes was formed January 1, 1937, and existed throughout that year.

(9) The Circuit Court of Appeals erred in holding and deciding that the adjudication by the District Court that a partnership valid for income tax purposes existed throughout the year 1937 does not estop the respondent from

asserting that no such partnership existed in 1940, when, according to the undisputed evidence in the instant case the business was conducted in the same fashion without substantial change of any kind from January 1, 1937, through the year 1940.

(10) The Circuit Court of Appeals erred in holding and deciding that the judgment of the District Court did not operate as *res adjudicata* or estoppel by judgment for the reason that the evidence presented to the jury in the trial of the former cause does not appear in the record of the case involving the year 1940.

(11) The Circuit Court of Appeals erred in holding and deciding that the decision of the Tax Court was supported by substantial evidence.

V

ARGUMENT

Summary of the Argument

Point A

The judgment of the District Court in the case of *Argo* v. *Willingham* is *res adjudicata* and operates as an estoppel to raise the issues there adjudicated which are material in the case involving the year 1940. In failing so to hold, the Circuit Court of Appeals rendered a decision which is not in accord with the applicable decisions of this Court, and which conflicts with the decision of the Circuit Court of Appeals for the Sixth Circuit in *Leininger* v. *Commissioner* (1936), 86 Fed. (2d) 791.

Tait v. *Western Maryland Railroad Co.* (1933), 289 U. S. 620, 53 S. Ct. 706, 77 L. ed. 1405;

Southern Pacific Railroad Co. v. *United States* (1897), 168 U. S. 1, 42 L. ed. 355, 18 S. Ct. 18;

Bates v. *Bodie* (1918), 245 U. S. 520, 62 L. ed. 444, 38 S. Ct. 182;.

The Last Chance Mining Co. v. *Tyler Mining Co.* (1894), 157 U. S. 683, 39 L. ed. 859, 15 S. Ct. 733;

New Orleans v. *Citizens Bank of Louisiana* (1897), 167 U. S. 371, 42 L. ed. 202, 17 S. Ct. 905;

Deposit Bank of Frankfort v. *Board of Councilmen* (1903), 191 U. S. 499, 48 L. ed. 276, 24 S. Ct. 154;

The Johnson Co. v. *Wharton* (1894), 152 U. S. 252, 38 L. ed. 429, 14 S. Ct. 608;

Leininger v. *Commissioner* (1934), 29 B. T. A. 874, affirmed (C. C. A., 6th 1936) 86 Fed. (2d) 791;

Donald v. *White Lumber Co.* (C. C. A., 5th 1934) 68 Fed. (2d) 441;

Commissioner v. *American Seating Co.* (1931), 50 Fed. (2d) 681;

Bennett v. *Commissioner of Internal Revenue* (C. C. A., 5th 1940) 113 Fed. (2d) 837, 130 A. L. R. 369;

Mary Haller (1932), 26 B. T. A. 395 (affirmed 68 Fed. (2d) 780);

Mayer v. *Kornegay* (1907), 152 Ala. 650, 44 So. 839;

Guin v. *Grasselli Chemical Co.* (1916), 197 Ala. 117, 72 So. 413;

Toy v. *Gong* (1918), 87 Ore. 454, 170 Pac. 936;

Kimmerle v. *Lowitz*, 203 Mich. 482;

Wood v. *Byington*, 2 Barb. Ch. (N. Y.) 387;

Hayes v. *Gudykunst*, 11 Pa. 221;

Bishop v. *Smith*, 9 Kan. App. 602, 58 Pac. 493;

Dutton v. *Woodman*, 9 Cush. (Mass.) 255;

2 Freeman on Judgments (5th Ed.) Sections 712; 900 et seq.; 904;

34 C. J., *Judgments*, Section 1313, page 905.

Point B

The judgment of the District Court in the case of *Argo* v. *Willingham* should have been given weight by the Tax Court in its consideration of the case involving the years 1938 and 1939. In failing so to hold, the Circuit Court of Appeals decided an important question of Federal law which has not been but which should be decided by this Court.

34 C. J., *Judgments*, Section 1508, p. 1067;
McDonald v. *Hannah* (Circ. Wash. 1892) 51 Fed. 73;
Coulson v. *Scott* (1910), 167 Ala. 606, 52 So. 436.

Point C

The decision of the Tax Court that Birmingham Electric & Manufacturing Company was not a bona fide partnership for income tax purposes in the years 1938, 1939, and 1940 was not supported by substantial evidence. In failing so to hold, the Circuit Court rendered a decision which is probably not in accord with the applicable decisions of this Court. The specific questions involved have not been but should be decided by this Court.

N. L. R. B. v. *Columbian E. & S. Co.* (1939), 306 U. S. 292, 83 L. Ed. 660, 59 S. Ct. 501;
N. L. R. B. v. *Thompson Products* (C. C. A., 6th, 1938) 97 Fed. (2d) 13;
Wilmington Trust Co. v. *Helvering* (1942), 316 U. S. 164, 86 L. Ed. 1352, 62 S. Ct. 984;
Helvering v. *Kehoe* (1940), 309 U. S. 277, 84 L. Ed. 751, 60 S. Ct. 549;
Helvering v. *Rankin* (1934), 295 U. S. 123, 79 L. Ed. 1343, 55 S. Ct. 732.

Point A

The judgment of the United States District Court for the Southern Division of the Northern District of Alabama is res adjudicata and gives rise to an estoppel by judgment to raise the issues there adjudicated and which are material in the case involving the year 1940.

The principle of *res adjudicata* or estoppel by judgment is clearly applicable in the case involving the year 1940 (Docket No. 112,248 in the Tax Court), in which the petition for review was filed in the Board of Tax Appeals (now the Tax Court) on August 24, 1942. The petition for review having been filed after June 15, 1942, the parties to the former action against the Collector in the District Court and those in the case here involving the year 1940 are deemed to be the same for the purpose of applying the principle of *res adjudicata* or estoppel by judgment. See Sec. 3772 (b) of the Internal Revenue Code (printed in the Appendix).

In its opinion, the Tax Court said with respect to the former case in the District Court and the case here involving the year 1940:

> "* * * the verdict of the jury and the judgment entered thereon involved a determination that there was a partnership for Federal income tax purposes in 1937. The question presented here in Docket No. 112,248 is the same except for different years, such question requiring a determination of whether there was a partnership for Federal income tax purposes between the same persons in the same business during the year 1940." (R. p. 86).

The principle of law applicable here has been many times enunciated in this Court and is succinctly stated in the case of *Southern Pacific R. Co.* v. *U. S.* (1897), 168 U. S. 1, 18 S. Ct. 18, 42 L. ed. 355, as follows:

> "The general principle announced in numerous cases is that a right, question, or fact distinctly put in issue,

> and directly determined by a court of competent jurisdiction, as a ground of recovery, cannot be disputed in a subsequent suit between the same parties or their privies; and, even if the second suit is for a different cause of action, the right, question, or fact once so determined must, as between the same parties or their privies, be taken as conclusively established, so long as the judgment in the first suit remains unmodified."

Applying that principle to tax matters, this Court has held that in an action for one year's taxes the parties are concluded as to the issues, rights and questions adjudicated by a former judgment respecting the tax of an earlier year. *Tait* v. *Western Md. R. Co.*, 289 U. S. 620, 53 S. Ct. 706, 77 L. ed., 1405. Directly in point with the instant cases is the decision of the Circuit Court of Appeals for the Sixth Circuit in the case of *Leininger* v. *Commissioner* (C. C. A. 6th, 1936), 86 Fed. (2d) 791. In that case the Commissioner taxed the taxpayer on one-half of the profits of the Eagle Laundry Company, a partnership (a one-half interest in which was owned by persons not related to the taxpayer) for the years 1920 to 1923. He owned a one-half interest in the partnership prior to the year 1920. He asserted that his wife had acquired one-half of his interest and had become a member of the partnership, and accordingly that she owned a twenty-five per cent interest and was taxable on twenty-five per cent of the profits, and that he owned a twenty-five per cent interest and was taxable on twenty-five per cent of the profits. The Board of Tax Appeals held that the taxpayer's wife was not a partner in the company. *Leininger* v. *Commissioner* (1930), 19 B. T. A. 621, affirmed 285 U. S. 136. Thereafter, for the years 1924-1929, inclusive, the Commissioner again taxed the taxpayer on one-half of the profits of the Company. The taxpayer appealed to the Board. It held that he was estopped by the former

judgment to assert that his wife was a partner in the Company. The Board said (29 B. T. A. 878):

> "As we have already pointed out, the years before us in the former proceedings were 1920 to 1923. The years now before us are 1924 to 1929. We have no doubt that if petitioner could prove that beginning with 1924 a new partnership agreement was entered into by which his wife became an actual partner in the Eagle Laundry Co. to the extent of a 25 per cent interest and petitioner became a partner to the extent of only a 25 per cent interest, he would be permitted to plead such an issue and offer proof in substantiation thereof and no doctrine of estoppel by judgment could prevent him from doing so. In such a case there would not only be a difference in the cause of action, in that the taxable years would be different, but there would be a new issue founded on different facts from those which existed in the prior years covered by the former proceedings. But petitioner does not contend that any new or different partnership agreement existed in the years 1924 to 1929 from that which existed in three of the years before us in the former proceedings, namely, 1921, 1922, and 1923."

* * * * * * *

> "It seems to us that the situation we have before us is not unlike that in *Tait v. Western Maryland Ry. Co., supra,* in which the Supreme Court affirmed the Circuit Court of Appeals in *Tait v. Western Maryland Ry. Co.,* 62 Fed. (2d) 933. In that case the Circuit Court, in affirming the District Court, said:
>
> " 'We are now asked to re-examine the evidence and reach a different conclusion, and the reasons given are that the evidence in the present case shows more clearly the gap between the present corporation and the one which originally issued the greater amount of the bonds; and also that this court did not fully appreciate the force of the facts in the former case which marked the difference between the present company and the

one which immediately preceded it. We are not impressed by this argument for if a question is actually and directly in issue and is judicially passed upon and determined in a suit, a party bound by the judgment cannot escape its effects by producing a new argument or new evidence in a subsequent action in support of the proposition decided against him. * * * If the appellee in the pending case is now permitted to produce additional evidence (which it may be said in passing was available at the first trial), to prove the point which was then relied on, the settled rule would be disregarded and the purpose of the doctrine of *res adjudicata* to put an end to litigation and to protect a successful litigant from a second trial of a controversy would be defeated.'

"Under the authorities above cited, we hold that the judgment of the Supreme Court in the former proceedings is an estoppel against the contentions made by petitioner in these proceedings."

The Circuit Court of Appeals for the Sixth Circuit affirmed the decision of the Board. 86 Fed. (2d) 791. The Court said:

"Assuming that this evidence was sufficient to reduce petitioner's interest in the partnership to 25 per cent, his difficulty is, that although this may have been his actual status at the beginning of the tax year 1920, the Supreme Court decided this very issue, that is, the extent of his interest, against him in the former proceeding and its decision is undoubtedly conclusive against his present contention, although different tax years are involved. See *Tait* v. *Western Maryland Ry. Co.*, 289 U. S. 620, 623, 53 S. Ct. 706, 707, 77 L. Ed. 1405; *United Shoe Mach. Corp.* v. *U. S.*, 258 U. S. 451, 458, 42 S. Ct. 363, 365, 66 L. Ed. 708; *Bates* v. *Bodie*, 245 U. S. 520, 526, 38 S. Ct. 182, 62 L. Ed. 444, L. R. A. 1918 C, 355; *Radford* v. *Myers*, 231 U. S. 725, 730, 34 S. Ct. 249, 58 L. Ed. 454; *Cromwell* v. *County of Sac*, 94 U. S. 351, 370, 24 L. Ed. 195; *Sutton* v. *Wentworth*, 247 F. 493, 501 (C. C. A. 1); *Santos* v. *Moreda*, 71 F.

(2d) 608, 609 (C. C. A. 1). The extent of petitioner's interest having been determined in the first suit, the question may not be relitigated in the second. If petitioner should now be permitted to introduce evidence available on the first hearing, or new evidence, or advance a different theory to sustain the contention decided against him in the first action, the purpose of *res adjudicata* would be frustrated. *Southern Pac. R. Co.* v. *U. S.*, 168 U. S. 1, 18 S. Ct. 18, 42 L. Ed. 355; *Tait* v. *Western Maryland Ry. Co.*, 62 F. (2d) 933, 935 (C. C. A. 4)."

The reasoning of the Circuit Court of Appeals is likewise applicable here: "The extent of petitioner's interest having been determined in the first suit, the question may not be relitigated in the second." 86 Fed. (2d), at p. 792.

The Tax Court based its decision that the former judgment did not operate as an estoppel in the case involving the year 1940 upon the fact that the evidence submitted to the jury upon the former trial did not appear in the record of the instant case. The pleadings, order on pretrial hearing, and the order of judgment in the former case in the District Court, however, were in evidence. (R. p. 141-161) The undisputed evidence in the instant case clearly shows, moreover, that the material facts respecting the operation of the partnership and its business during 1940 were the same as those existing in 1937.

In the many decisions in which it is held that a judgment as to some question or fact therein adjudicated operates as an estoppel in a subsequent cause of action in which the same question or fact is material, it is uniformly held that only the fact of the prior judgment need be proved, and that it is immaterial upon what evidence it was based.

In *Southern Pacific R. Co.* v. *U. S.*, *supra*, the controlling matter in issue in both the prior case and the pending controversy was whether certain maps filed by the At-

lantic and Pacific Ry. Co. in 1872 (prior to either decision) were valid maps of definite location. It was held that a fact once established and made the basis of a decree could not thereafter be disputed in a second suit, even upon a different cause of action, but that "the thing adjudged" must be "received in evidence 'as irrefragable truth' ". The Court concluded, after a detailed consideration of the pleadings and judgment in the former case that the issue in the former case and that in the pending controversy were the same. It was obviously not considered essential to examine or to discuss the evidence in the earlier case. After quoting with approval the statement from the opinion in *Last Chance Mining Company* v. *Tyler, infra,* to the effect that the relevant inquiry, in such case, is whether a fact has been judicially determined and not upon what evidence it was determined, the Court held:

> "* * * it would seem that *the controlling inquiry is whether, under the pleadings in the former cases, the sufficiency of the Atlantic & Pacific maps of 1872 as maps of definite location was a matter in issue and determined,* as between the United States and the Southern Pacific Railroad Company. That that matter was in issue and was actually decided in the former cases, is too clear to admit of doubt. That it was material is equally clear;" (Italics supplied)

In *Bates* v. *Bodie* (1918) 245 U. S. 520, 62 L. Ed. 444, 38 S. Ct. 182, this Court, in discussing when a judgment operated as an estoppel to raise questions therein determined said:

> "But how find the matters in issue or the points controverted upon the determination of which the judgment was rendered? The obvious answer would seem to be that for the issues we must go to the pleadings; for response to them and their determination, to the judgment; and each may furnish a definition of the other."

In *Last Chance Mining Company* v. *Tyler Mining Company* (1894) 157 U. S. 683, 39 L. Ed. 859, 15 S. Ct. 733, the issues decided by a judgment relied on as giving rise to an estoppel were determined by reference to the findings of fact, the pleadings, and the judgment itself. It was objected that the applicable state statutes did not provide for findings of fact in such a case, and, further, that there was only a judgment by default. The Court held that the complaint and the judgment nevertheless established what issues were adjudicated, and that it was immaterial upon what evidence the judgment was reached. The opinion reads in part:

> "* * * if we ignore the findings altogether and look simply at the judgment and the complaint, this appear: The single ground stated in the complaint upon which superiority of right is claimed is priority of location. A judgment for the plaintiffs upon such a complaint is necessarily an adjudication in favor of that priority of location. There is no other fact upon which it can rest. * * *
>
> "The essence of estoppel by judgment is that there has been a judicial determination of a fact, and the question always is, has there been such determination, and not upon what evidence or by what means was it reached. * * *"

In *Tait* v. *Western Maryland Ry. Co.* (C. C. A. 4th, 1933) 62 F. (2d) 933 (affirmed in this Court in 289 U. S. 620, 53 S. Ct. 660, 77 L. Ed. 1405) it was held that a prior decision permitting deduction for income tax purposes of the amortized portion of the discount on certain bonds for the years 1918 and 1919 operated as an estoppel in a subsequent action involving the years 1920 and 1925. As to the contention that different and material facts with respect to the history of the taxpayer's predecessor corporations were presented in the later controversy and that the doc-

trine of *res adjudicata* was therefore inapplicable, the Court said:

> "• • • We are not impressed by this argument, for if a question is actually and directly in issue, and is judicially passed upon and determined in a suit, a party bound by the judgment cannot escape its effects by producing a new argument or new evidence in a subsequent action in support of the proposition decided against him. • • •"

See also *New Orleans* v. *Citizens Bank of Louisiana* (1897) 167 U. S. 371, 42 L. Ed. 202, 17 S. Ct. 905; *Deposit Bank of Frankfort* v. *Board of Councilmen* (1903) 191 U. S. 499, 48 L. Ed. 276, 24 S. Ct. 154; *The Johnson Co.* v. *Wharton* (1894) 152 U. S. 252, 38 L. Ed. 429, 14 S. Ct. 608.

In *Donald* v. *White Lumber Co.* (C. C. A., 5th 1934), 68 F. (2d) 441, the court held that a former judgment as to the value of certain timber as of March 1, 1913 was conclusive evidence of such value in a subsequent action in which such value was a material issue. The District Court "had before it and considered all the pleadings, its own findings of fact, conclusions of law and the judgment in the prior suit tried before it." The Circuit Court of Appeals held that the District Court correctly decided that the prior judgment worked an estoppel as to the value of the timber in 1913, it being said:

> "A prior judgment is conclusive evidence as to all matters in issue and thereby determined in a subsequent suit upon a different cause of action between the same parties or their privies."

It will be noted that the evidence upon which the prior judgment was based was not introduced in evidence and that the Court apparently deemed this omission immaterial.

In case of *Mary Haller* (1932) 26 B. T. A. 395 (affirmed 68 F. (2d) 780) concerns the existence of a partnership for

income tax purposes. In a proceeding respecting income taxes for the years 1924 and 1925 the Commissioner pleaded *res adjudicata,* contending that the questions of law and fact raised by the petitioner had been decided adversely to her by an earlier decision of the Board of Tax Appeals. At the hearing in the latter case, "the pleadings in those proceedings which involved the years 1917 to 1923 * * * the Board's decision and the orders of redetermination were submitted and received in evidence." It is clear that the evidence before the Board in the earlier case was not introduced in evidence. Mary Haller contended that under the will of her husband, who died in 1895, the income from a grocery business was distributable 1/7 to her and 1/7 to each of her children during the years 1924 and 1925 and further, that an agreement between herself and her children had created a partnership during the years 1924 and 1925. The Board held that substantially the same questions had been raised and decided in the former proceeding and that the former decision precluded Mary Haller "from asserting that a partnership in the profits of the grocery business *existed at any time during the years in controversy in the former proceedings, i. e., prior to January 1, 1924*"; and that "in accordance with the same principles our former decision is conclusive as to the construction of the will of Jacob Haller and the codicil thereto to the effect that under the will the children of Jacob Haller had no legal interest in the net profits of the grocery business."

In the case of *Bennett* v. *Commissioner of Internal Revenue* (C. C. A. 5th 1940), 113 Fed. (2d) 837, 130 A. L. R. 369, it was held that a judgment that a taxpayer was liable on an endorsement of certain notes and that he could take a bad debt deduction when he paid one of them in 1934 was *res adjudicata* as to similar notes which he took up in 1935 under the same circumstances. The taxpayer

pleaded *res adjudicata* by reason of the decision of a district court respecting the note taken up in 1934 and attached to his pleading "certified copies of the pleadings, the findings of fact, the conclusions of law, the opinion of the court and the judgment in that case". The Circuit Court of Appeals held that the Commissioner was estopped by the judgment of the District Court from contending that the point in issue was otherwise than as there adjudged. No reference was made to the necessity for introducing the evidence upon which the said judgment of the District Court was based.

See also the case of *Commissioner of Internal Revenue* v. *American Seating Company* (C. C. A. 7th 1931), 50 F. (2d) 681, in which it was held, in spite of the express objection that the evidence in the prior case was not submitted in evidence, that findings of fact by the Board of Tax Appeals were *prima facie* evidence, in a later case, of the truth of the findings.

It is clear from the authorities cited that if the facts and issues determined by the prior judgment are material here, that judgment, properly introduced in this case, constitutes conclusive evidence of such facts and issues, and operates as an estoppel to raise them again. It is clear, further, that only the judgment, and not the evidence in the prior case, need be proved.

To ascertain the extent to which the former judgment is an estoppel, therefore, the inquiry is, first, what issues, questions and facts were decided by that judgment, and, second, which of those issues, questions and facts are material here. The following questions were necessarily decided by the former judgment:

> (1) The taxpayer on January 1, 1937, made valid bona fide gifts to members of his family of their several interests in the business.

(2) The taxpayer on January 1, 1937, ceased to be the individual owner of the business and the several partners became the owners thereof.

(3) A partnership valid for income tax purposes was formed January 1, 1937, and existed throughout that year.

These questions are clearly material and, indeed, controlling here. It is obvious from the findings of fact and the opinion of the Tax Court that it based its decision upon the theory that no partnership, valid for income tax purposes, *had ever been formed;* that the "economic status" of the petitioner *had never changed,* and that he remained the individual owner of the business. The brief resume of facts in the opinion of the Circuit Court of Appeals reveals that its decision, also, is predicated upon the view that no partnership valid for income tax purposes *was ever formed.* The Government has never contended that the operations of the partnership have changed in any way since 1937.

These issues are, further, material and controlling in the instant case because of the fact that it is presumed, in the absence of evidence to the contrary, that the facts as they existed at the time of the former judgment continued to exist: In 34 C. J., *Judgments,* Sec. 1313, page 905, it is said:

> "The estoppel of a judgment extends only to the facts in issue as they existed at the time the judgment was rendered, and does not prevent a reexamination of the same questions between the same parties where in the interval the facts have changed or new facts have occurred which may alter the legal rights or relations of the litigants. But in the absence of evidence to the contrary the facts as they existed at the time of the former judgment will be presumed to continue."

It has been frequently held that where the fact of a partnership is litigated and determined it becomes *res adjudicata* in subsequent actions where the same issue comes into ques-

tion. *Toy* v. *Gong*, 87 Ore. 454, 170 Pac. 936; *Kimmerle* v. *Lowitz*, 203 Mich. 482; *Wood* v. *Byington*, 2 Bard. Ch. (N. Y.) 387; *Hayes* v. *Gudykunst*, 11 Pa. 221; *Bishop* v. *Smith*, 9 Kan. App. 602, 58 Pac. 493; *Dutton* v. *Woodman*, 9 Cush. (Mass.) 255; 2 Freeman on *Judgments* (5th Ed.), Section 904. The status adjudicated in the first case is presumed to continue until facts showing a change are proved. *Mayer* v. *Kornegay* (1907), 152 Ala. 650, 44 So. 839; *Guin* v. *Grasselli Chemical Co.* (1916), 197 Ala. 117, 72 So. 413.

The presumption that the facts remain as they were at the time of the former judgment renders that judgment of controlling importance here, in view of the Tax Court's finding that the evidence before it afforded "no basis for a positive finding" that a valid partnership for income tax purposes did not exist in the tax years in question. (R. 90) The fact of the existence of a bona fide partnership for income tax purposes throughout the year 1937, established by the former judgment, shifts the burden of proof to the Government. This burden, it is clear from the Tax Court's finding, the Government failed to meet.

Point B

Weight should have been given the decision of the District Court in the case of Argo v. Willingham by the Tax Court in its consideration of the case involving the years 1938 and 1939.

The principle of *res adjudicata* or estoppel by judgment would be applicable to the case involving the years 1938 and 1939, but for the technical rule that as to proceedings filed with the Board of Tax Appeals before June 15, 1942, the Collector is not in privity with the Commissioner. See *United States* v. *Nunnally Investment Company* (1942), 316 U. S. 258, 86 L. Ed. 1455, 62 S. Ct. 1064; Sec. 3772 (b), Internal Revenue Code, printed in the Appendix. The

petition to review involving those two years was filed before June 15, 1942. It has been demonstrated, we believe, that the judgment of the District Court is conclusive against the respondent in the case involving the year 1940. In reality and in substance the question whether the partnership was a bona fide partnership for Federal income tax purposes was tried and settled by the District Court. The Government first took an appeal to this Court, but later moved to dismiss the appeal and acquiesced in the judgment. The record shows that the situation in all material respects remained the same. It seems clear that even if, for the reason above indicated, the former judgment is not conclusive in the case involving the years 1938 and 1939, it is entitled to great weight as evidence in that case. To disregard it entirely is to ignore the substance of that matter. Furthermore, as we have pointed out, the status of the petitioner with respect to the partnership for income tax purposes having been adjudicated, it is presumed to continue in the absence of evidence to the contrary. The former judgment adjudicated that the partnership was formed on January 1, 1937, was thereafter operated in good faith, and was valid for income tax purposes. Irrespective of any technical question of privity as between the Commissioner and the Collector, great weight should have been given to the former judgment by the Tax Court in its consideration of the case involving the years 1938 and 1939.

The general rule with respect to the weight to be given former judgments in subsequent cases involving different parties is stated as follows in 34 C. J., *Judgments*, Sec. 1508, page 1067:

> "Aside from the question of its conclusiveness as a bar or estoppel, a judgment is admissible and competent evidence * * * as persuasive although not conclusive, evidence of the facts which it adjudges or determines, even as against strangers."

See also *McDonald* v. *Hannah* (Circ. Wash. 1892), 51 Fed. 73; *Coulson* v. *Scott* (1910), 167 Ala. 606, 52 So. 436.

We submit that this rule applies here with peculiar force in view of the fact that the Government is actually the party in interest in both cases and that the technical rule of want of privity between the Collector and the Commissioner is based merely upon the artificial consideration that the Collector is sued in his personal capacity.

In failing to hold that the Tax Court erred in giving no weight to the former judgment in its consideration of the cases involving the years 1938 and 1939, the Circuit Court of Appeals decided an important Federal question which has not been but which should be decided by this Court.

Point C

The decision of the Tax Court that Birmingham Electric & Manufacturing Company was not a bona fide partnership for income tax purposes in the years 1938, 1939 and 1940 was not supported by substantial evidence.

Under the rule often announced, the decisions of the Tax Court must be supported by "substantial evidence." *Helvering* v. *Kehoe* (1940), 309 U. S. 277, 84 L. Ed. 751, 60 S. Ct. 549; *Wilmington Trust Co.* v. *Helvering* (1942), 86 L. Ed. 1352, 316 U. S. 164, 62 S. Ct. 984; *Helvering* v. *Rankin* (1934), 295 U. S. 123, 79 L. Ed. 1343, 1349, 55 S. Ct. 732.

In *N. L. R. B.* v. *Columbian E. & S. Co.* (1939), 306 U. S. 292, 83 L. Ed. 660, 59 S. Ct. 501, "substantial evidence" is defined as follows:

> "Substantial evidence is more than a scintilla, and must do more than create a suspicion of the existence of the fact to be established. 'It means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion,' Consolidated Edison Co. v. National Labor Relations Bd., 305 U. S. 197, ante, 126, 59 S. Ct. 206, supra, and *it must be enough to*

justify, if the trial were to a jury, a refusal to direct a verdict when the conclusion sought to be drawn from it is one of fact for the jury."

A similar definition in *N. L. R. B.* v. *Thompson Products* (C. C. A. 6th, 1938), 97 Fed. (2d) 13, is as follows:

> "'Substantial evidence' means more than a mere scintilla. It is of substantial and relevant consequence and excludes vague, uncertain, or irrelevant matter. It implies a quality of proof which induces conviction and makes an impression on reason. It means that the one weighing the evidence *takes into consideration all the facts presented to him and all reasonable inferences, deductions and conclusions to be drawn therefrom and, considering them in their entirety and relation to each other, arrives at a fixed conviction.*
>
> "The rule of substantial evidence is one of fundamental importance and is the dividing line between law and arbitrary power. Testimony is the raw material out of which we construct truth and, *unless all of it is weighed in its totality,* errors will result and great injustices be wrought."

The Tax Court failed to consider all the relevant evidence before it in that it disregarded the former judgment of the District Court which (as we have shown under Points A and B) constituted, with respect to the year 1940, conclusive evidence and, with respect to the years 1938 and 1939, persuasive evidence of facts material to a determination of the instant case.

The Tax Court stated that the evidence before it afforded "no basis for a positive finding that the activities and services of the petitioner were the main factors in the production of the income" of the partnership. If the Tax Court had considered the said judgment as evidence of the facts therein found, it is clear that in the absence of evidence affording such a "positive finding" the Tax Court would have been compelled to find that a bona fide partnership for

income tax purposes existed during the taxable years. The ultimate finding of the Tax Court is, therefore, based upon an exclusion of and a failure to consider material evidence shifting the burden of proof to the Commissioner and its said ultimate finding is, therefore, unsupported by substantial evidence.

Further, the Tax Court's finding that the petitioner failed to show "that his activities and services were not the main factors in the production of the income" of the company is based upon two subsidiary findings which are directly controverted by the evidence. The Tax Court stated, in its opinion:

> "We are not informed as to whether other persons were employed." (R. 89)

The average number of employees in the business during the tax years was shown by the evidence to be as follows:

Year	Employees
1938	26
1939	25
1940	27

(See respondent's Exhibits H-M, certified in original form.)

The Tax Court based its inference that petitioner had failed to show that his services were not the main factors in the production of the partnership income in large measure on its subsidiary finding that the partnership's annual earnings were "50 per cent and more in excess of the capital investment in physical assets." An analysis of the evidence shows, as is demonstrated in the statement of facts herein, that the percentage of return upon the company's investment, including current expenditures for merchandise, labor, etc., was, during the tax years, actually less than ten per cent. The inference based on this sub-

sidiary finding clearly ignores material and controlling evidence as to the factors which produced the partnership income.

It is clear that inferences of fact and ultimate findings which are based on subsidiary findings directly controverted by the record are not supported by substantial evidence.

In *Wilmington Trust Co.* v. *Helvering, supra,* inferences of fact found by the Board of Tax Appeals were not disturbed because it appeared that such inferences were based upon subsidiary findings of fact which were supported by substantial evidence. It follows that inferences of fact by the Tax Court are not conclusive when based upon subsidiary findings which are directly controverted by the evidence.

In failing to hold that the decision of the Tax Court in this case was unsupported by substantial evidence, the Circuit Court of Appeals decided an important question of Federal law in a manner which is probably not in accord with the applicable decisions of this Court and which involves important questions of Federal law which have not been but which should be decided by this Court.

Conclusion

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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